

Transmittal Supplement

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TO: The Committee on Ways and Means
U.S. House of Representatives

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SUBJECT: Hearing on Tax Reform and the U.S. Manufacturing Sector

Attached please find a written statement to be included in the official record of the full committee hearing held on July 19, 2012 on Tax Reform and the U.S. Manufacturing Sector. Please direct questions concerning this statement to the name and address listed above.

**WRITTEN STATEMENT SUBMITTED FOR CONSIDERATION TO:
COMMITTEE ON WAYS AND MEANS
U.S. HOUSE OF REPRESENTATIVES**

**HEARING ON TAX REFORM AND
THE U.S. MANUFACTURING SECTOR**

HEARING DATE: JULY 19, 2012

SUBMITTED BY JOHN P. SURMA

**CHAIRMAN OF THE BOARD OF DIRECTORS and
CHIEF EXECUTIVE OFFICER**

**ON BEHALF OF
UNITED STATES STEEL CORPORATION**

**600 Grant Street
Pittsburgh, PA 15219**

AUGUST 2, 2012

**JOHN P. SURMA
UNITED STATES STEEL CORPORATION**

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United States Steel Corporation (“U. S. Steel”), a Fortune 500 company, is an integrated steel producer of flat-rolled and tubular steel products with major production operations in North America and Europe. An integrated steel producer uses iron ore and coke as primary raw materials for steel production. According to World Steel Association’s latest published statistics, we were the thirteenth largest steel producer in the world in 2011. U. S. Steel is also engaged in other business activities consisting primarily of iron ore mining, railroad transportation services, and real estate operations.

U. S. Steel appreciates the opportunity to contribute to the discussion that occurred during the Hearing on Tax Reform and the U.S. Manufacturing Sector (July 19, 2012). Our company also previously submitted a written statement in connection with the Hearing on the Interaction of Tax and Financial Accounting on Tax Reform (February 8, 2012).

My written testimony is based on my experience as the Chairman of the Board of Directors and Chief Executive Officer of U. S. Steel. One of the key goals of my job, simply put, is to guide our company’s business decisions to ensure that shareholder capital is invested where it can produce the greatest return. Leading an enterprise as complex as U. S. Steel, of course, involves many other considerations that also determine our success, but return on capital is how the markets view and reward performance.

The fiscal situation our country presently faces requires pragmatic leadership and vision. There is a growing awareness that the U.S. is falling behind in the global competition for capital investment. Our manufacturing sector has been neglected for too long and our society and its citizens are worse for it. As this Committee recommends policies to revive economic growth, address fiscal imbalance, and increase revenues to fund government, I

urge you to recognize that not all taxable income provides the same impact to our economy and that overly simplistic policies will not deliver optimal results.

I firmly believe in the role capital-intensive manufacturing must play in any large, healthy economy. Ours is an industry that creates value from the most basic of earth's elements. The transformations we effect create advanced materials that preserve and expand our food supply and that can be used to build our homes, our cars, our roads, bridges and other infrastructure. Manufacturing is an industry that supports good-paying jobs. Steel is an industry where, for every direct job, there exist another seven elsewhere in the economy. Similarly, for every \$1 increase in sales of iron and steel mill products, total output in the U.S. economy increases by \$2.66. Few other industries even come close. I submit that a vital manufacturing sector is something this Government should strive to encourage and preserve because it is a proven source of employment and an engine of economic growth and prosperity.

The main goal of business tax reform, while being mindful of current and projected fiscal considerations, should be to make the United States of America a more attractive venue for investment, especially in manufacturing, in order to promote economic growth and job creation. While we are encouraged by proposals for a reduction in the corporate tax rate to induce new capital investment, we continue to be extremely concerned that too narrow a focus on rates alone could lead to reduced economic growth. Specifically, the retention and even the enhancement of accelerated depreciation, the retention of the last-in, first-out (LIFO) inventory method, the ability to use existing minimum tax credit (MTC) carryforwards, and a significant reduction in the corporate tax rate would be powerful tools to promote new investment in the United States.

For U. S. Steel, and we would expect for most manufacturers, the availability of cash is extremely important in making investment decisions. Cash flow and liquidity considerations are major components of investment decisions and provide businesses with the confidence to continue to invest in projects that will grow America's manufacturing base. Cash flow is as important as book earnings, and companies that emphasize book earnings over cash flow may find themselves investing in projects that over the long term result in lower economic value and less job growth.

U. S. Steel requires significant capital investments for its steel manufacturing and iron ore facilities and we look to the net present value of future cash flows as a critical factor in making discretionary investments. Taxes are a major element of cash flow for any project, and are determined by taking into account both the tax rate and the timing of tax depreciation deductions. A lower tax rate will undoubtedly produce a future cash flow benefit, but that benefit may be more than offset by increased cash taxes due to delaying depreciation deductions. Accelerated depreciation and bonus depreciation have a substantial impact on all of U. S. Steel's investment decisions and are built into our models for evaluating the viability of capital projects. Eliminating accelerated depreciation, LIFO, and MTCs in order to pay for lower tax rates will likely increase taxes on capital-intensive manufacturers like U. S. Steel and thereby reduce capital investment in domestic manufacturing. This is not the direction that business tax reform should take.

Instead of eliminating accelerated depreciation in order to pay for lower tax rates, we respectfully propose the Committee consider a different approach, which is making 50% bonus depreciation permanent and retaining accelerated depreciation for the remaining 50% basis. To mitigate the negative revenue effects, the rate reduction could be phased in over time. The end result of rate reduction and accelerated depreciation would encourage new investment and allow American manufacturing to grow. Using dynamic scoring, this could even result in increased revenue to the Treasury.

Our company is presently undertaking a large capital investment program with total spending in 2011 and 2012 exceeding \$1 billion. We are currently building a new coking facility in Pennsylvania and a coke substitute facility in Indiana, and recently completed a \$100 million upgrade to pipe mill facilities in Ohio. A 50% owned joint venture is currently building a continuous annealing line in Ohio that will manufacture high strength steel for the domestic auto industry. We also have several dozen other projects underway for facilities in Alabama, Illinois, Indiana, Michigan, Minnesota, Texas and elsewhere. These investments have created thousands of construction jobs and will result in hundreds of permanent jobs and billions of dollars in goods and services being bought from local and national suppliers. However, these and future capital

projects will not be as viable if accelerated depreciation is changed or eliminated, and some may not be economically supportable at all without accelerated depreciation.

A lower overall tax rate benefits both old and new investments—although on a present value basis it is more beneficial to existing facilities. To the extent that accelerated depreciation is eliminated to reduce the tax rate, new investment is actually penalized because it bears the full burden of reduced depreciation. This combination of lower tax rates and reduced depreciation deductions increases the cash flows (and profitability) of old investments relative to new ones, and ironically reduces the likelihood of new domestic investments in manufacturing being made. In contrast, a lower tax rate combined with accelerated depreciation provides a strong incentive for American businesses, like U. S. Steel, to invest in new domestic manufacturing projects, thus creating new jobs and expanding the U.S. economy.

Other countries with lower tax rates than the United States still encourage capital investment to fuel growth. For example, Canada, where we also have substantial operations, has made investment more attractive by reducing the corporate tax rate while continuing to allow accelerated depreciation. Canada has a lower federal corporate tax rate than the U.S. (the Canadian corporate rate in 2012 is 15%, which, when combined with provincial rates is approximately 25%), and it makes accelerated depreciation available to encourage investment. Even if the U.S. corporate income tax rate (about 40% for federal and states) is reduced to be closer to the Canadian rate, if accelerated depreciation is eliminated in the U.S. then companies with manufacturing operations in both countries will still have a tax incentive to invest in Canada rather than in the U.S. Keeping accelerated depreciation in place would better position the United States as a desirable location for new manufacturing investment.

Like the elimination of accelerated depreciation, the elimination of the last-in, first-out (“LIFO”) method of inventory accounting would have a detrimental impact on U.S. manufacturers. The objective of LIFO is to permit taxpayers to properly match current revenues with current replacements costs, and thereby pay taxes on income that is actually realized. LIFO was first allowed for federal income taxes in the 1930s, and has continued through today without significant modification. U. S. Steel has consistently used the LIFO method for valuing inventories since 1941.

The elimination of the LIFO method would result in many U.S. manufacturers paying a one-time tax on their LIFO reserve for inventory on hand, which is the difference between current replacement costs compared to its value under LIFO. U. S. Steel estimates that the repeal of LIFO could cost us over \$450 million at current tax rates, reducing our ability to invest in our U.S. operations and create new manufacturing jobs. Many other domestic manufacturers, including many of our customers, also use the LIFO inventory method, and its repeal could also have as significant an impact on them as it would on us. As the result of increased taxes from the repeal of LIFO, these manufacturers would have less cash available for expansion, further slowing our nation's recovery, and reducing future job growth. Even if this tax increase due to the repeal of LIFO is spread over a number of years as has been suggested, the negative impact on capital available for future investment in domestic manufacturing would be significant.

Another item that tax reform should take into account is minimum tax credit ("MTC") carryforwards generated under the current corporate income tax regime. MTCs are generated when corporations have tentative minimum tax ("TMT") in excess of regular tax and are subject to the alternative minimum tax ("AMT"). MTCs can be carried forward to later years to reduce regular tax down to the TMT amount. MTCs available for carryover are generally recorded as assets under GAAP. U. S. Steel, like many companies in manufacturing and mining, are often subject to the AMT because of regular tax deductions for items such as accelerated depreciation, LIFO, and percentage depletion, all or a part of which are tax preferences in computing AMT.

Several tax reform proposals, including the recently proposed "Pathway to Job Creation Through a Simpler, Fairer Tax Code Act of 2012 (H.R. 6169)," recommend the elimination of AMT. While we support this, we are concerned about the treatment of unused MTCs if the AMT is eliminated. If existing MTCs available for carryover can't be used against income taxes generated after tax reform, U. S. Steel and many other manufacturing and mining companies will lose these assets and will have to take a financial book charge for MTC carryforwards reflected as assets on the financial books, impacting earnings and negatively affecting the ability to raise funds for future capital investments. We recommend that MTC carryforwards be retained under tax reform and either be refunded or allowed as a credit against income tax determined under tax reform.

While a lower tax rate would benefit U.S. corporate taxpayers, many manufacturers, especially those in capital intensive, cyclical industries would be disproportionately harmed by the elimination of accelerated depreciation, LIFO, and MTCs. Companies that make useful things in the U.S. and have the greatest multiplier effect on our economy should not bear the brunt of paying for lower taxes for other sectors, such as financial services and retail trade, activities which are not likely to lead to widespread prosperity.

When deciding how to compensate for a rate reduction, tax provisions that have been in place for many years and that help domestic manufacturers grow their businesses and create new jobs should not be abandoned. A reduction in the tax rate, combined with the retention of a limited number of growth-oriented provisions such as accelerated depreciation, retaining the option of LIFO inventory accounting, and the use of MTCs, is a winning formula that promotes capital investment and job creation, strengthening companies that produce products in the U.S. and the overall U.S. economy.

We welcome the ability to further contribute to the tax reform discussion and thank you, again, for the opportunity to address the Committee.